

*adjusted for recoveries of bad debts* means an adjustment for the full amount recovered with respect to bad debts previously charged to the reserve during any of the applicable taxable years.

(Sec. 585(b)(4), of the Internal Revenue Code of 1954 (83 Stat. 618; (26 U.S.C. 585(b)(4))))

[T.D. 7532, 43 FR 3109, Jan. 23, 1978, as amended by T.D. 7835, 47 FR 42342, Sept. 27, 1982; T.D. 8513, 58 FR 68757, Dec. 29, 1993]

### § 1.585-3 Special rules.

(a) *Treatment of reserve.* For taxable years beginning after July 11, 1969, if a financial institution to which section 585 and § 1.585-1 apply establishes a reserve pursuant to section 585(a) (or, for taxable years beginning before January 1, 1987, section 166(c)), any bad debt in respect of a loan (whether or not such loan is an eligible loan) must be charged to the reserve for losses on loans provided for by § 1.585-1 for the taxable year in which the bad debt occurs. For such a year, any recovery of a bad debt previously charged to the reserve account in respect of a loan (whether or not such loan is an eligible loan) must be credited to such reserve in the taxable year of recovery regardless of whether such credit causes the reserve to exceed the permissible amount. If, as a result of net recoveries during the taxable year, the reserve balance exceeds the permissible amount, a taxpayer is not required to report the excess as taxable income. In such a case, the excess over the otherwise permissible amount in the reserve account precludes current reasonable additions to the reserve and may affect future reasonable additions. Recoveries of bad debts which were not charged to the reserve shall not be credited to such reserve, but shall be treated as taxable income subject to the provisions of section 111. No item other than a loan as defined in § 1.585-2 (e)(2) shall be charged to the reserve for losses on loans.

(b) *Accounting for reserve.* A financial institution to which section 585 and § 1.585-1 apply which establishes a reserve pursuant to section 585(a) (or, for taxable years beginning before January 1, 1987, section 166(c)) shall establish and maintain a permanent record of such reserve. Copies of Federal income

tax returns and amended returns with attached schedules satisfy the requirements of this paragraph provided that such returns are permanently maintained by the financial institution and the balance of the reserve for losses on loans established pursuant to section 585(a) (or former section 166(c)) can be readily reconciled with the reserve for losses on loans maintained by the financial institution for financial statement purposes. The requirements of this paragraph would also be satisfied if a financial institution establishes and maintains a permanent subsidiary ledger reflecting an account for the reserve for losses on loans established pursuant to section 585(a) (or former section 166(c)) provided the balance in such account can be readily reconciled with the balance of the reserve for losses on loans for financial statement purposes maintained in any other ledger. The permanent records maintained pursuant to this section must reflect any changes in the amount initially added to the reserve for losses on loans and the amount finally determined by the taxpayer to be a reasonable addition to the reserve for losses on loans.

(Sec. 585(b)(4), of the Internal Revenue Code of 1954 (83 Stat. 618; (26 U.S.C. 585(b)(4))))

[T.D. 7532, 43 FR 3114, Jan. 23, 1978, as amended by T.D. 8513, 58 FR 68757, Dec. 29, 1993]

### § 1.585-4 Reorganizations and asset acquisitions.

(a) *In general.* In computing a reasonable addition to the reserve for losses on loans for the first taxable year ending after a transaction to which section 381(a) applies and for subsequent taxable years, the separate reserves for losses on loans, the amount of loans outstanding, the total bad debts sustained (adjusted for recoveries), and the amount of eligible loans outstanding of the distributor or transferor corporation and the acquiring corporation (or, in the case of a consolidation, the transferor corporations) shall be combined for all applicable years. Thus, for example, in applying § 1.585-2(c)(1)(i) for the first taxable year ending after the distribution or transfer, the total bad debts sustained during the 5 preceding taxable years are the sum of the bad debts sustained